

Edgar Filing: SYNERGX SYSTEMS INC - Form 10QSB

SYNERGX SYSTEMS INC  
Form 10QSB  
February 11, 2005

U.S. SECURITIES AND EXCHANGE  
COMMISSION Washington,  
D. C. 20549

FORM 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the fiscal quarter ended December 31, 2004  
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TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT  
For the transition period from to

Commission file number 0-17580  
-----

SYNERGX SYSTEMS INC.

(Exact name of small business issuer as specified in its charter)

Delaware  
-----

11-2941299  
-----

(State or jurisdiction of incorporation or  
organization)

(IRS employer identification  
Number)

209 Lafayette Drive, Syosset, New York 11791  
(Address of Principal Executive Offices) (Zip code)

(516) 433-4700  
-----

(Issuer's telephone number)

Check whether the issuer (1) has filed all reports required to be filed by  
Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for  
such shorter period that registrant was required to file such reports), and (2)  
has been subject to such filing requirements for the past 90 days.

Yes  No

State the number of shares outstanding of each of the issuer's classes of common  
equity, as of the latest practicable date: As of February 4, 2005, 5,140,196  
shares of Registrant's Common Stock were issued and outstanding.

Transitional Small Business Disclosure Format (check one) Yes  No

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### SYNERGX SYSTEMS INC. AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

#### ASSETS

##### CURRENT ASSETS

Cash and cash equivalents	\$
Accounts receivable, principally trade, less allowance for doubtful accounts of \$323,523	5,
Inventories	2,
Deferred taxes	
Prepaid expenses and other current assets	

##### TOTAL CURRENT ASSETS

PROPERTY AND EQUIPMENT -at cost, less  
accumulated depreciation and amortization of \$1,549,064

##### OTHER ASSETS

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TOTAL ASSETS

---  
\$10,  
===

See accompanying Notes to the Condensed Consolidated Financial Statements

SYNERGX SYSTEMS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES

Note payable to bank  
Notes and capital leases payable - current portion  
Accounts payable and accrued expenses  
Deferred revenue

Dec

\$ 1,

2,

---

3,

TOTAL CURRENT LIABILITIES

Notes and capital leases payable - less current portion  
Deferred taxes

TOTAL LIABILITIES

---

4,

---

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY

Preferred stock, 2,000,000 shares authorized-  
none issued and outstanding  
Common stock, 10,000,000 shares authorized, \$.001  
par value; issued and outstanding 5,136,862 shares  
Capital in excess of par  
Accumulated deficit

6,

(

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6,

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TOTAL STOCKHOLDERS' EQUITY

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

\$10,

====

See accompanying Notes to the Condensed Consolidated Financial Statements

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SYNERGX SYSTEMS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the Three Months Ended 2004 -----
Product sales	\$3,248,383
Subcontract sales	98,133
Service revenue	1,120,387
	-----
Total revenues	4,466,903 -----
Cost of product sales	2,469,216
Cost of subcontract sales	79,681
Cost of service	720,534
Selling, general and administrative	1,358,191
Interest expense	22,901
Depreciation and amortization	57,757
Loss on equity investment	10,000
	-----
	4,718,280 -----
(Loss) before (benefit) from income taxes	(251,377) -----
(Benefit) from income taxes:	
Current	(79,000)
Deferred	(17,000)
	-----
	(96,000)
Net (Loss)	\$ (155,377) =====
(Loss) per common share	
Basic (loss) per share	\$ (0.03) =====
Diluted (loss) per share	\$ (0.03) =====
Weighted average number of common shares outstanding	5,136,862
Weighted average number of common and dilutive common shares outstanding	5,136,862

See accompanying Notes to the Condensed Consolidated Financial Statements

SYNERGX SYSTEMS INC. AND SUBSIDIARIES

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## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Three Month End 2004 -----
<b>OPERATING ACTIVITIES</b>	
Net (loss)	\$(155,377)
Adjustments to reconcile net (loss) to net cash provided by (used in) operating activities:	
Depreciation and amortization	57,757
Deferred tax (benefit)	(17,000)
Provision for doubtful accounts	-
Loss on equity investment	10,000
Changes in operating assets and liabilities:	
Accounts receivable	943,411
Inventories	(2,117)
Prepaid expenses and other current assets	(11,429)
Other assets	14,252
Accounts payable and accrued expenses	(294,062)
Deferred revenue	(9,368)
	-----
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>536,067</b>
	-----
<b>INVESTING ACTIVITIES</b>	
Purchases of property and equipment	(121,070)
	-----
<b>NET CASH (USED IN) INVESTING ACTIVITIES</b>	<b>(121,070)</b>
	-----
<b>FINANCING ACTIVITIES</b>	
Principal payments on notes payable and capital lease obligations	(16,767)
Payments and proceeds from revolving line of credit - net	(700,000)
Proceeds from exercise of stock options and warrants	
	-----
<b>NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>	<b>(716,767)</b>
	-----
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(301,770)</b>
Cash and cash equivalents at beginning of period	928,507
	-----
Cash and cash equivalents at end of period	\$ 626,737
	=====
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>	
Cash paid during the period for:	
Income taxes	\$5,455
Interest	\$22,902

See accompanying Notes to the Condensed Consolidated Financial Statements

SYNERGX SYSTEMS INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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THREE MONTHS ENDED DECEMBER 31, 2004 AND 2003

(UNAUDITED)

## 1. BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary in order to make the financial statements not misleading have been included. Results for the three months ended December 31, 2004 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2005. For further information, refer to the consolidated financial statements and footnotes thereto included in Synergx Systems Inc. ("Synergx" or "the Company") and Subsidiaries' annual report on Form 10-KSB for the year ended September 30, 2004.

## 2. REVENUE RECOGNITION

Product sales include sale of systems, which are similar in nature, that involve fire alarm, life safety and security (CCTV and card access), transit (on board systems) and communication (paging, announcement and audio/visual). Product sales represent sales of product along with the integration of technical services at a fixed price under a contract with an electrical contractor or end user customer or customer agent. Product sales are allocated using a constant gross profit percentage over the entire contract, and recognized, using the percentage-of-completion method of accounting. The Company utilizes a units-of-work performed method to measure progress towards completion of the contract. The effects of changes in contract terms are reflected in the accounting period in which they become known. Contract terms provide for billing schedules that differ from revenue recognition and give rise to costs and estimated profits in excess of billings, and billings in excess of costs and estimated profits. Costs and estimated profits in excess of billing were not material at December 31, 2004 and 2003 and have been included in accounts receivable. There were no billing in excess of costs and estimated profits at December 31, 2004 and 2003.

Subcontract sales principally represents revenue related to electrical installation of wiring and piping performed by others for the Company when the Company acts as the prime contractor and sells its products along with electrical installation. Subcontract revenue is also recognized during the entire project using the percentage-of-completion method of accounting as electrical installation is performed at the job site.

Service revenue from separate maintenance contracts is recognized on a straight-line basis over the term of the respective contract, which is generally one year. Non-contract service revenue is recognized when services are performed.

SYNERGX SYSTEMS INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THREE MONTHS ENDED DECEMBER 31, 2004 AND 2003

(UNAUDITED)

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### 3. INVENTORIES

Inventories are priced at the lower of cost (first-in, first-out) or market and consist primarily of raw materials.

### 4. LONG TERM DEBT

On October 9, 2003, the Company entered into a new \$3 million revolving credit facility with Hudson United Bank (the "Credit Facility"). The Credit Facility has an interest rate of prime plus 1/4% on outstanding balances (5.5% at December 31, 2004) and expires in October 2005. The Company will be discussing with its bank for an extension in its credit facility beyond its October 2005 due date. The Credit Facility is secured by all assets of the Company and all of its operating subsidiaries. Advances under this Credit Facility are measured against a borrowing base calculated on eligible receivables and inventory.

At December 31, 2004, the full amount of the Credit Facility was available under the borrowing base calculation and \$1,215,676 was outstanding under this facility.

The Credit Facility includes certain restrictive covenants, which among other things, impose limitations on declaring or paying dividends, acquisitions, and capital expenditures. The Company is also required to maintain certain financial ratios and tangible net worth covenants. At December 31, 2004 the Company was not in default with any of its financial covenants.

## SYNERGX SYSTEMS INC. AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### THREE MONTHS ENDED DECEMBER 31, 2004 AND 2003

(UNAUDITED)

### 5. EARNINGS (LOSS) PER SHARE

The Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128 "Earnings Per Share" which requires companies to report basic and diluted earnings per share ("EPS") computations. Basic EPS excludes dilution and is based on the weighted-average common shares outstanding and diluted EPS gives effect to potential dilution of securities that could share in the earnings of the Company. Diluted EPS reflects the assumed issuance of shares with respect to the Company's employee stock option plan and warrants. The Company did not have stock based compensation for the three months ended December 31, 2004 or 2003.

	For the Three Months ended December 31	
	2004	2003
	----	----
Basic EPS Computation		
Net (Loss) available to common stockholders	\$ (155,377)	\$ (126,377)
Weighted average outstanding shares	5,136,862	4,166,862
Basic (Loss) per share	\$ (.03)	\$ (.03)
	=====	=====
Diluted EPS Computation		

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(Loss) available to common stockholders and assumed conversions	\$ (155,377) -----	\$ (126) -----
Weighted-average shares	5,136,862 -----	4,166 -----
Plus: Incremental shares from assumed conversions		
Employee Stock Options*		
Warrants*		
Dilutive potential common shares	N/A ----	N/ ----
Adjusted weighted-average shares	5,136,862 =====	4,166 =====
Diluted (Loss) per share	\$ (.03) =====	\$ =====

\*All warrants and options were antidilutive in 2004 and 2003.

### 6. RECENT ACCOUNTING PRONOUNCEMENT

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" SFAS 123 (Revised) addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123 (Revised) requires an entity to recognize the grant-date fair-value of stock options and other equity-based

## SYNERGX SYSTEMS INC. AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued

THREE MONTHS ENDED DECEMBER 31, 2004 AND 2003

(UNAUDITED)

### 6. RECENT ACCOUNTING PRONOUNCEMENT (continued)

compensation issued to employees in the income statement. The revised statement generally requires that an entity account for those transactions using the fair-value-based method, and eliminates the intrinsic value method of accounting in APB 25, which was permitted under SFAS No. 123, as originally issued.

The revised statement requires entities to disclose information about the nature of the share-based payment transactions and the effects of those transactions on the financial statements.

SFAS No. 123 (Revised) is effective for small business issuers financial statement for the first interim or annual reporting period that begins after December 15, 2005, with early adoption encouraged.

The Company is currently evaluating the impact that this statement will have on its financial condition or results of operations.



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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### LIQUIDITY AND CAPITAL RESOURCES

In October 2003, the Company entered into a new \$3 million revolving credit facility with Hudson United Bank (the "Credit Facility"). This credit facility has an interest rate of prime plus 1/4% and expires in October 2005. Initial proceeds from the new credit facility were used to pay off a credit facility with Citizens Business Credit. Advances under the Credit Facility are measured against a borrowing base calculated on eligible receivables and inventory. The Credit Facility is secured by all assets of the Company and all of its operating subsidiaries.

The Credit Facility includes various covenants, which among other things, impose limitations on declaring or paying dividends, acquisitions and capital expenditures. The Company is also required to maintain certain financial ratios and tangible net worth covenants. At December 31, 2004, the Company was not in default with any of its financial covenants and at such time the full amount of the Credit Facility was available under the borrowing base calculation. At December 31, 2004, \$1,215,676 was owed under the Credit Facility.

Net cash provided by operations for the three months December 31, 2004 amounted to \$536,067 as compared to cash used in operations of \$500,235 for the comparable prior year. The increase in cash provided by operations was primarily due to a \$454,072 increase in collection of accounts receivable and from a \$295,522 decrease in payments of accounts payable and accrued expenses. The net cash inflow of \$536,067 from operations during the 2004 period along with cash on hand was used for equipment purchases of \$121,070 and to decrease bank borrowing by \$700,000. During the prior year three month period financing activities included \$316,200 of proceeds from exercise of warrants to purchase common stock by Genterra Inc. and \$3,125 from the exercise of stock options by employees to purchase common stock under the Company's stock option plan.

The ratio of the Company's current assets to current liabilities decreased to approximately 2.35 to 1 at December 31, 2004 compared to 3.20 to 1 at December 31, 2003. The decrease in the current ratio is due to our bank debt being a current liability in 2004 and a long term liability in 2003. Had our bank debt remained a long term liability in 2004, the current ratio would have increased to 3.40 to 1. The Company will be discussing with its bank extending the credit facility beyond its October 2005 due date. The effect of an extension will be to return the credit facility to a long term liability.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Results of Operations

#### Revenues and Gross Profit

	Three Months Ended December 31, -----	
	2004	2003
	(In thousands of dollars)	
Product Revenue	\$3,249	\$3,019

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Subcontract Revenue	98	79
Service Revenue	1,120	1,104
	-----	-----
Total Revenue	\$4,467	\$4,202
Gross Profit Product	\$779	\$ 916
Gross Profit Subcontract	18	13
Gross Profit Service	400	307
	-----	-----
Total Gross Profit	\$1,197	\$1,236
Gross Profit Product %	24%	30%
Gross Profit Subcontract %	18%	16%
Gross Profit Service %	36%	28%
Total Gross Profit %	27%	29%

### Revenues

The Company's product revenues during the three months ended December 31, 2004 were \$3,249,000 compared to \$3,019,000 for the prior year period. This increase of 8% reflected increased shipments with respect to New York City Transit projects compared to last year when the Company experienced delays in securing approvals for production and shipment. However, product revenues in our Dallas, Texas market area declined significantly from a very high level in 2003 due to a very competitive market environment.

Subcontract revenue increased slightly during the current three month period to \$98,000 from \$79,000 in the comparable prior year period. The Company was responsible for various small electrical installations during both the 2004 and 2003 periods.

Service revenues increased during the current three month period primarily due to an increase in service contracts resulting from the addition of new service customers and from certain customers converted to "all in" contracts that cover call-in service. Accordingly, there was a decrease in call-in service on fire alarm systems (replacement parts and service required by buildings) .

## 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Gross Profit

Gross profit on product revenues for the three months ended December 31, 2004, decreased 15% to \$779,000 compared to \$916,000 for the prior year period. This decrease in absolute gross profit is primarily related to a change in the mix of product revenues with more revenue derived from products with lower gross margin. In particular there was a decline in higher margin revenue from tenants. The decrease in gross profit percentage in 2004 to 24% compared to 30% in 2003 also reflects the change in product mix (noted above) and the inability to absorb fixed overhead costs at our Dallas facility due to a decline in sales in that market area.

Gross profit related to subcontract revenues for the three months ended December 31, 2004 increased in absolute terms due to the increase in revenue related to electrical installation. In addition, the gross profit percentage was higher during the three months of 2004 as mark ups on electrical installations were higher.

Gross profit from service revenues increased during the three months ended

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December 31, 2004 due to the increase in service revenue. The absolute gross profit and gross margin percent increases were due in part from a decrease in technical staff as the Company reevaluated its customer support staffing level.

### Income Before Tax

The increase in loss before income taxes during the three months ended December 31, 2004 was consistent with budget due to the decrease in gross profit caused by a change in mix of product revenues and from unabsorbed fixed overhead in Dallas. The decrease in product gross margin was offset by higher gross margin from subcontract and service revenues. The increase in service gross margin was caused in part by a decrease in technical staff. In addition, selling, general and administrative expenses remained at approximately the same level as the prior year and supported higher product revenues during 2004. Interest expense increased during 2004 due to higher interest rates. Depreciation and amortization increased as the Company upgraded its management information equipment and systems. For 2004, the Company also recorded a loss of \$10,000 on its equity in the operating loss of Secure 724 LP compared to a loss of \$20,000 in 2003.

### Tax Provision

The Company's current income tax benefit represents the benefit from net operating loss carryback as it relates to federal, state and local income taxes. Deferred taxes represent the net change in deferred tax assets and non current deferred tax liability as it related to certain timing differences of book and tax deductions.

## 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Order Position

The Company's order position, excluding service, at December 31, 2004 was \$11,568,000 as compared to \$12,814,000 at September 30, 2004 and \$16,157,000 at December 31, 2003. This order position includes large orders received for several subway complexes which will be deliverable over several years as the projects are released. In addition, the backlog includes \$1.3 million of orders for communication and announcement systems from several transit car manufacturers, that will be shipped over the next 15 month period. While quotation activity is brisk, there is no assurance when orders will be received and whether the order position will increase. Due to the fact that the Company's products are sold and installed as part of larger mass transit construction projects, there is typically a delay between the booking of the contract and its revenue realization. The order position includes, and the Company continues to bid on projects that might include significant subcontractor labor (electrical installation performed by others). The Company expects to be active in seeking orders where the Company would act as a prime contractor and be responsible for management of the project as well as electrical installation.

## Item 3. Controls and Procedures

Evaluation of disclosure controls and procedures. At the period end of this Quarterly Report on Form 10-QSB, the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company's disclosure controls

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and procedures. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded, as of the end of the quarter covered by this report, that:

The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified.

That Company's disclosure controls and procedures are effective to ensure that such information is accumulated and communicated to the Company's management, and made known to the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decision regarding the required disclosure.

There have been no changes in the Company's internal controls over financial report that have materially affected, or is reasonably likely to materially affect the Company's internal controls over financial reporting during the period covered by this Quarterly Report.

### Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

Not Applicable

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Not applicable

Item 3. Defaults Upon Senior Securities.

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders.

None

Item 5. Other Information.

Item 6. Exhibits and Reports on form 8-K.

(a) Exhibits

31.1 Certification of Daniel S. Tamkin pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of John A. Poserina pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certifications of Daniel S. Tamkin and John A. Poserina pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(b) Reports on Form 8-K

None

SIGNATURES

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Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SYNERGX SYSTEMS INC  
(Registrant)

/s/ John A. Poserina

-----  
John A. Poserina,  
Chief Financial Officer  
(Principal Accounting and  
Financial Officer), Secretary  
and Director

Date: February 11, 2005